REPUBLIC OF POLAND

CONVERGENCE PROGRAMME
2022 UPDATE

Warsaw, April 2022

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Foreword

The European Union Member States submit annually the updates of stability or convergence programmes to the European Commission and the Ecofin Council. Based on the analysis of these documents, the Ecofin Council subsequently issues recommendations for the Member States' economic policies to be taken into account when designing budgets for the next year.

This Convergence Programme (hereinafter referred to as the "Programme") presents a medium-term forecast of the economic situation in Poland and its public finance by 2025. It is also part of the Multiannual Financial Plan of the State (MFPS) adopted by the Council of Ministers, developed in accordance with the Act of 27 August 2009 on public finance (Journal of Laws of 2021, item 305, as amended) – hereinafter referred to as the "Public Finance Act". The MFPS will serve as the basis for the preparation of the draft budget act for 2023.

The Programme was prepared in accordance with Council Regulation No 1466/97/EC of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, and the Guidelines on the format and content of Stability and Convergence Programmes adopted by the Ecofin Council in June 2017. The Programme also takes into account the guidance of the European Commission of March 2 this year on the conduct of fiscal policies of the Member States in 2023.

The macro-fiscal scenario presented in the Programme uses data and draft legislation and programmes highly likely to be implemented, available until 1 April this year.

The Programme was created simultaneously with this year's edition of the National Reform Programme that presents an overview of the structural reforms implemented in connection with the European Green Deal and the EU Council's recommendations for Poland from previous years. The Council's opinion on this Programme and the Council's recommendations regarding the National Reform Programme are usually discussed by the Polish Parliament.

The Programme does not take into account the impact of the implementation of the National Recovery and Resilience Plan, waiting for the approval by the EU institutions. The Plan responds to the EU Council's recommendations for Poland regarding structural policies, also from 2019-2020, in the form of reforms and investments, in particular for the green and digital transition.

Summary

The Polish economy did well during the pandemic, and in 2021, it was one of the first EU economies to return to the GDP level from before the pandemic. The prospects for the economic growth will depend, among others, on the development of the conflict in Ukraine. This year, the GDP growth rate is expected to slow down to 3.8%, and to 3.1% in the forecast horizon. A higher economic activity growth rate will be possible due to financing public and private investments from the EU Recovery and Resilience Facility.

The general government deficit in 2021[1] was 1.8% of GDP, and the general government debt reached 53.8% of GDP. Revenue growth, which contributed to a significant reduction in the deficit, resulted not only from a good economic situation, but also from high consumer price dynamics. Measures taken by the government to mitigate the effects of inflation, including changes in the tax system, as well as support for Ukrainian refugees, will be a significant burden for the general government this year. The currently projected general government deficit will increase to 4.3% of GDP this year.

The macro-fiscal scenario, including the deficit forecast for 2023, takes into account the European Commission's guidance to focus next year on controlling the current expenditure growth rate, with priority given to investment expenditure. Assuming the minimal consolidation rate resulting from the Stability and Growth Pact, the general government deficit and debt would be reduced in 2025 to 2.5% of GDP and 49.7% of GDP, respectively. The European Commission is likely to update its guidance in the coming weeks to take into account the effects of the conflict in Ukraine on the EU economy. The new guidance may be taken into account when developing the draft budget act for 2023.

The armed conflict in Ukraine may affect the convergence of the Polish economy and the economies of the euro area countries. In connection with the sanctions imposed on Russia, it can be expected that the scale and strength of political and economic ties between Poland and the countries of the common currency area will be significantly strengthened. Poland will continue to participate in the process of deepening the Economic and Monetary Union, in particular in activities aimed at ensuring stability in the euro area. Given the current degree of similarities between the economies of Poland and the euro area – in particular as regards the development level measured, for example, through GDP *per capita* – Poland's membership in the euro area could be a source of disturbances in the economy. However, when considering the adoption of the single currency, it is worth taking into account not only economic, but also political risks and benefits. Therefore, the decision on the rate of integration with the euro area should be based on a thorough analysis.

According to the current forecasts, the mechanism for an automatic return to the conventional stabilising expenditure rule will expire at the end of 2022, so will the general escape clause in the EU. Having regard to the discussion on the fiscal framework in the EU and the geopolitical situation, further adjustments to this rule are not excluded.

[1] According to the preliminary information on the general government deficit and debt to GDP ratio, announced by Statistics Poland on 1 April this year.

I. Economic outlook

I.1. Current prospects

In 2021, the Polish economy entered the path to a rapid recovery of economic activity after the pandemic recession. The average economic growth rate (qoq, sa) was almost twice as high as the long-term average. The economic results in the following quarters turned out to be better than expected, despite the third and fourth waves of the pandemic and continued administrative restrictions. This was due to several factors: the adaptation of companies and households to operating in the face of restrictions, improvement in the situation in the main export markets, and strong support from macroeconomic policy. Already in Q2 2021, GDP reached the level from before the pandemic, i.e. earlier than in most EU countries.

In 2021, the European economy recorded a significant recovery. Throughout the year, GDP in the euro area grew by 5.3%, and in Q4, the economic activity level was higher than before the outbreak of the pandemic. A high growth rate was recorded in domestic demand, especially private consumption, backed by the improvement in the labour market situation and realization of pent-up demand by households. On the other hand, the continuing disruptions in global supply chains and high prices of energy commodities had a negative impact on the economic conditions. Combined with the successive waves of the pandemic at the end of 2021 and the beginning of 2022, these led to a weakening of economic activity in the euro area during this period.

The improvement in the economic situation in the external environment as well as the high competitiveness of Polish companies and their growing importance in global value chains contributed to a rebound in exports already in the second half of 2020. Growth of exports continued also in 2021, which – apart from the higher domestic demand growth rate – was conducive to a significant increase in industrial production. A rapid growth was recorded also in private consumption, supported by improved consumer sentiment, a good situation on the labour market and satisfaction of postponed demand (which was confirmed by a marked decline in the household savings rate). Last year, however, the rate of growth in investment was relatively low. In this case, the losses incurred in 2020 have not been recovered yet. This was due to, among others, a low investment activity growth rate in the general government. Disruptions in global supply chains, problems with international transport, rising prices of raw materials and commodities as well as high uncertainty as to future developments were reflected in the record-high increase in inventories and a significant positive contribution of this category to GDP growth. As a result, the domestic demand growth rate in 2021 was very high, which in turn translated into a significant increase in imports and – given lower export growth rate – a negative contribution of net exports to GDP growth. Throughout 2021, GDP increased by 5.9%, i.e. definitely more than forecast during the year.

Higher frequency data from the beginning of this year, concerning industrial production, retail sales and, in particular, construction and assembly production, indicate that the annual GDP growth rate remained high in Q1 2022, despite the fifth wave of the pandemic. However, the outbreak of the war in Ukraine fundamentally changed the situation as regards the economic outlook in the following quarters of this year (See Chapter I.2).

The high economic activity growth rate was reflected in the further improvement in the situation on the labour market. The number of the employed[2], starting from the second half of 2020, was growing to reach the level from before the pandemic already in Q4 2020. In 2021 this category increased by as much as 2.6%, following a slight decline recorded a year earlier. This increase coincided with a marked improvement in the participation rate[3] (by 2.0 percentage points, to 57.8%), which – despite a significant increase in labour demand – contributed to a slight increase in the unemployment rate[4] to 3.4%. The

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[2] LFS, 15-89 years

[3] LFS, 15-89 years

[4] LFS, 15-74 years

high rate of the labour demand growth, the low level of the unemployment rate (lower than the NAWRU[5] rate), and the further increase in the minimum wage contributed to the increase in the rate of growth of wages in the economy.

The quick recovery in economic activity was also accompanied by more significant and higher than expected inflation growth. At the beginning of 2021, inflation was close to the inflation target, but since the spring the rate of growth of the prices of consumer goods and services has accelerated. The increase in inflation was mainly related to increases in energy prices, i.e. fuel prices as a result of the increase in crude oil prices in global markets as well as electricity and gas prices. Food prices also started to gradually increase. Core inflation was also elevated throughout 2021. It was mainly the effect of the high rate of growth of service prices, as a result of, among others, the pandemic (increased costs related to the need to implement sanitary solutions and the price effect of opening up the economy) and increases in housing fees. Increased inflationary pressure is also due to high transport costs and disruptions in global supply chains, which, together with rising prices of raw materials, resulted in increased cost pressure on producers. In annual terms, inflation in 2021 was 5.1%.

Due to the persisting price growth rate, a package of anti-inflation measures (Anti-Inflation Shields 1.0 and 2.0) was announced to lower the inflation growth rate in 2022 and limit the negative effects of increased inflation on households. The packages include measures related to taxes and protective measures aimed at compensating price increases for the lowest-income households. Lowering the excise tax and VAT rates on energy commodities (electricity, heat, gas, fuels) and food will help limit the increase in their prices (compared to the scenario without the Shields).

For most of 2021, the Monetary Policy Council (MPC) continued its current monetary policy. The MPC pointed to the external reasons for the increase in inflation observed since Q2, its expected temporary nature and the uncertainty as to the sustainability and scale of the economic recovery after the pandemic-related recession. The basic interest rates of the National Bank of Poland (NBP) remained at record low levels (including the reference rate of 0.1%). The NBP also purchased debt securities as part of structural open market operations. The scale of these operations clearly decreased in the autumn of 2021, and in December, the programme was phased out (the last regular operation took place in November). In 2021, the NBP bought at 13 auctions bonds with a total nominal value of PLN 36.9 billion. In total, in the last two years, the NBP purchased bonds with a nominal value of PLN 144 billion. In October 2021, due to the risk of inflation persisting above the target in the monetary policy transmission horizon, the Monetary Policy Council raised the reference rate by 0.4 percentage point to 0.5% and increased the required reserve ratio from 0.5% to 2.0%. The cycle of interest rate hikes continued in November and December, when the reference rate increased by 0.75 and 0.50 percentage points, respectively, up to 1.75%. In the first quarter of 2022, as a result of three consecutive increases (by a total of 1.75 percentage points), the reference rate reached 3.5%. Moreover, in February, the MPC increased the required reserve ratio to 3.5% (i.e. to the level from before the pandemic).

In 2021, the current account recorded a deficit of 0.6% of GDP. For most of the year, the annual dynamics of imports remained significantly higher than those of exports. Import, apart from growing domestic demand, was clearly supported by higher prices of energy commodities imported from abroad. This was compounded by increased stockpiling by enterprises, related to concerns about future shortages of inputs and/or a further increase in their prices. Exports remained under pressure caused by the supply problems in industrial processing (lack of raw materials and components for production). This was particularly evident in the automotive industry. As a result, the balance of trade in goods in relation to GDP deteriorated. High income of foreign investors earned through their capital engagement in Polish entities deepened the primary income deficit.

In 2021, the PLN exchange rate was mainly determined by the COVID-19 pandemic and expectations regarding monetary policy abroad and in Poland. The first of the above factors was particularly pronounced in March and November, when successive waves of the pandemic led to a weakening of PLN. The market expectations concerning the tightening of monetary policy in the United States, increasing since mid-year, also had a negative impact on the Polish currency. In turn, growing

[5] non-accelerating wage rate of unemployment

expectations for the continuation of the NBP interest rate increase series strengthened PLN at the end of the year. On average, in 2021, the EUR/PLN exchange rate was 4.57 and the USD/PLN exchange rate was 3.86.

At the turn of February and March 2022, Russia's armed aggression against Ukraine led to a sharp increase in risk aversion in the global financial markets and the flow of capital to assets traditionally regarded by investors as safe havens. Due to the geographic proximity of Poland and other Central and Eastern European countries to the areas affected by hostilities, their currencies have been put under particularly strong pressure. The EUR/PLN exchange rate increased to the highest level ever (5.0), and the USD/PLN exchange rate reached its long-term maximum. Due to the dynamic weakening of PLN, the NBP carried out a series of interventions on the foreign exchange market. The central bank's measures were supported by the Ministry of Finance, that informed, in the announcement of 2 March this year, that the foreign currency funds at its disposal would be exchanged primarily on the foreign exchange market, and the exchange of these funds at the NBP would be of a complementary nature. In the second half of March, the Polish currency recovered a large part of its losses, supported by better sentiment in the global financial markets and the strong fundamentals of the Polish economy.

I.2. Medium-term scenario

The Russian invasion of Ukraine, international sanctions against Russia, the abrupt increase in the number of refugees arriving in Poland and the ongoing COVID-19 pandemic result in significant uncertainty as regard the medium-term macroeconomic scenario. This scenario accounts for the impact of the war in Ukraine on the Polish economy through: worsening economic sentiment, lower global GDP growth, growing prices of raw materials, problems in global supply chains, costs of accepting refugees by Poland and the impact of transfers to refugees on domestic consumption. However, the scenario does not take into account the impact of refugees and migrants returning to Ukraine on the domestic labour market, substantiating it with high uncertainty as to the scale and direction of this impact (see Chapter III.1).

The adopted scenario assumes that the real GDP growth rate in 2022 will reach 3.8%, and 3.2% in 2023. In the following years, the Polish economy will grow at a rate of 3.0% and 3.1%. The potential output growth rate is 3.5% in 2022, 3.3% in 2023 and 2.9% in the following two years. The main determinants of the growth rate of the economy potential will include the decreasing labour supply, accumulation of productive capital and an increase in the efficiency of inputs. The output gap, clearly negative in 2020-2021 (-2.0% and -0.2% of potential GDP, respectively), will grow, to reach 0.3% over the forecast horizon. Despite the projected increase in economic activity in the coming years, the negative trends in the size of the working age population will result in a lower potential GDP growth rate. Although NAWRU has been decreasing since 2003, in the last two years of the forecast horizon it is expected to stabilise at the level of 2.7-2.8% and limit its positive impact on the potential growth rate almost to zero.

In 2022, private consumption will increase in real terms by 5.9%. In the following years, this growth rate will gradually slow down (4.0% and 2.7% in 2023 and 2024, respectively), to reach 2.9% at the end of the forecast horizon. High private consumption – especially in the first years of the forecast horizon – will be enhanced by the good situation on the labour market (low unemployment rate and sustained real growth of the wage bill), tax cuts and refugees' consumption expenditure.

The real growth rate of gross fixed capital formation will amount to 4.8% and 4.0% in 2022 and 2023, respectively. In the following years, it will drop to 2.5% in 2024 and 2.7% in 2025. The relatively high growth rate in the initial years of the forecast will result mainly from the increase in public investments, e.g. for national defence (the scenario assumes that an increase in defence spending will partially increase investment and partially public consumption). Private investment growth will be low throughout the forecast horizon due to rising financing costs resulting from interest rate increases, uncertainty related to the war in Ukraine, high prices of raw materials and problems in global supply chains.

In Q3-Q4 2021, there was a significant increase in inventories caused, among others, by rising prices on global markets and problems with supply chains. They are expected to be gradually used in the following years (negative change in inventories), which will have a negative impact on GDP growth, but at the same time will generate additional exports and investments.

The war in Ukraine is another – next to the COVID-19 pandemic – shock to global supply chains. It may result in lower availability of some raw materials, leading to interruptions in the production of selected goods (e.g. steel and some automotive components). Nevertheless, the direct impact of the war on Polish trade should be moderate. In 2021, the share of Russia in exports from Poland was 2.8%, while that of Ukraine was 2.2%. In the case of imports, 6.0% came from Russia, and 1.5% from Ukraine. Thus, it is expected that the export growth rate in 2022-2025 will be 4.5%, 4.0%, 3.6% and 3.6%, respectively, while imports will increase by 4.1%, 3.1%, 2.9% and 2.9%, respectively.

In the second half of 2021, inflation began to accelerate sharply, to reach 10.9% yoy (preliminary data) in March this year. According to the scenario, in 2022 the inflation rate will remain at a high level – 9.1% on average throughout the year, to gradually decrease in subsequent years (7.8% in 2023, 4.8% in 2024 and 3.5% in 2025). In 2022, PLN exchange rates are assumed to stabilise at the level of 4.59 PLN/EUR and 4.10 PLN/USD. For the subsequent years of the forecast horizon (2023-2025), it was technically assumed that the EUR/PLN exchange rate would remain at the average rate from 2021 (i.e. 4.57) and the PLN/USD exchange rate would remain at the level from Q1 this year.

The second year of the pandemic aggravated Poland's demographic problems – the total population in Poland decreased by approximately 180,000 people. As a result of long-term demographic trends, this decline will continue. The scenario assumes a negative population growth rate in the 15-89 age group at the level of 0.3% in 2022 and 0.4% per annum in 2023-2025. These figures do not account for the influx of refugees from Ukraine (see Chapter III.1).

It is expected that in 2022 the number of the employed will increase by 1.2%, as a result of a further increase in economic activity and a decline in the unemployment rate. In the next three years covered by the forecast, the number of the employed will decline by 0.1-0.3%, mainly due to demographic changes. Changes in the number of the employed population take into account the assumption made in the Programme that the number of people employed in the general government will stabilise by 2025.

Poland is still a country with a very low unemployment rate. According to the Labour Force Survey (LFS) it is estimated that the unemployment rate will drop from 3.4% in 2021 to 2.7% in 2022. In the following years, unemployment will remain low (2.6% over the forecast horizon), as a result of demographic trends and the economic growth rate remaining close to the potential.

In 2022, an increase in labour costs per employee was assumed at 10.3%, thus exceeding the forecast inflation level (9.1%). A similar situation is expected in the next year (10.1% increase in labour costs per employee with 7.8% inflation). Despite high inflation, excessive wage pressure will be curbed by, among others, deterioration in sentiment and a slowdown in the GDP growth, as a result of the war in Ukraine and the entry onto the labour market of some refugees (this issue is described in Chapter III.1). Along with the slowdown in inflation, the real rate of growth of labour costs per employee in 2024-2025 will be approx. 3.5%.

Table 1. Economic growth - key elements of the forecast

	2021	2022	2023	2024	2025
GDP in real terms, growth in %	5.9	3.8	3.2	3.0	3.1
Gross fixed capital formation, growth in %	3.8	4.8	4.0	2.5	2.7
LFS unemployment rate, in %	3.4	2.7	2.6	2.6	2.6
CPI	5.1	9.1	7.8	4.8	3.5

Source: Statistics Poland, Ministry of Finance.

II. General government balance and debt

II.1. Policy strategy and medium-term objectives

In accordance with the recommendations of the EU Council[6], in 2022, Poland continues budgetary policy focused on supporting the economy weakened by the effects of the pandemic. The last year's amendment to the Public Finance Act[7] allowed for further anti-crisis measures. The amended Act extended the clause providing for the return to the stabilising expenditure rule in accordance with its original formula from 2 to 3 years. In turn, public investment will increase insignificantly this year to 4.3% of GDP (from 4.2% of GDP in 2021), which is in line with another EU Council's recommendation not to limit nationally financed investment in 2022.

In June last year, the EU Council recommended – in case of an improvement in the economic situation – taking measures to ensure the sustainability of public finance in the medium term and increase investment in order to stimulate the economic growth potential. In March this year, the European Commission invited Member States to prepare this year's stability and convergence programmes based on its guidance for next year's budgetary policies. In 2023, the current expenditure growth rate should be limited, the quality and structure of public finance should be improved, and nationally financed investment should be maintained, or – where justified – even increased. In countries with low and medium debt, the investment priority should be given to green and digital transformation. The budget policies of the EU countries should, however, be flexible: an improvement or deterioration in economic prospects should entail adequate changes in the expenditure growth rate.

The Programme was developed assuming consolidation at the minimum rate resulting from the Stability and Growth Pact, taking into account control of current expenditure in 2023 as recommended by the European Commission, and the priority treatment of capital expenditure (See Chapter II.4). The new burdens for the general government were also taken into account: in 2022, expenditure related to the influx of Ukrainian refugees and an additional increase in defence spending from 2023. The European Commission has declared the guidance for 2023 will be updated at the end of May this year, at the latest. The amended guidance may be taken into account when developing the draft budget act for 2023.

Table 2. General government - key elements of the forecast

% of GDP	2021	2022	2023	2024	2025
Nominal balance	-1.8	-4.3	-3.7	-3.1	-2.5
- revenue	42.3	40.0	39.9	39.7	39.7
- expenditure	44.2	44.4	43.6	42.8	42.2
Structural balance	-1.9	-4.2	-3.7	-3.2	-2.7
Gross debt	53.8	52.1	51.5	51.0	49.7

Source: Ministry of Finance, Statistics Poland.

II.2. Actual balances

The situation of the general government in 2021 was determined by the macroeconomic situation of the country and the scale of measures aimed at combating the COVID-19 pandemic. According to the preliminary estimates of Statistics Poland from 1 April this year, the general government deficit (in line with the ESA2010 methodology) amounted to 1.8% of GDP. This represents an improvement by approx. 5.1 percentage points as compared to 2020. The lower deficit was the result of a significant decrease in

[6] Council Recommendation of 18 June 2021 containing the Council's opinion on the Convergence Programme for 2021 presented by Poland (2021/C 304/21)

[7] The Act of 11 August 2021, amending the Public Finance Act and certain other acts (Journal of Laws, item 1535, as amended)

the general government expenditure in relation to GDP by 4.3 percentage points (including subsidies for producers – by 2.4 percentage points) with an increase in revenue by 0.8 percentage points. The level of general government revenue and expenditure in 2021 and the detailed revenue and expenditure structure in relation to GDP are presented in Table 14.

Measures aimed at containing and combating the effects of the COVID-19 pandemic as well as supporting the affected entities were financed primarily from the COVID-19 Counteracting Fund established at the end of March 2020 at Bank Gospodarstwa Krajowego and by the Polish Development Fund as part of government programmes. These were appropriately included in the general government statistics.

General government expenditure

In 2021, the general government expenditure amounted to 44.2% of GDP and was clearly lower than in the previous year – by 4.3 percentage points. The reduction on the spending side in 2021 was in general due to lower expenditures on supporting entities affected by the COVID-19. It was reflected mainly in the "subsidies for entrepreneurs" category which decreased as a ratio to GDP by 2.4 percentage points to 1.2%.

Investment reached 4.1% of GDP (nominal growth by 3.2%). In order to support investment in the local government sub-sector in 2020-2021, funds under the Government Fund for Local Investments worth approx. PLN 13 billion, from the COVID-19 Counteracting Fund, were mobilised. A nominal increase in investment by approx. 7% was recorded in the central government sub-sector, where the implementation of long-term programmes aimed at road construction and modernisation of railway infrastructure was continued.

In 2021, social programmes from previous years were continued. These were:

- Family 500 plus programme with the cost (excluding service costs, childcare supplement and the supplement to the lump sum) at PLN 40.3 billion compared to PLN 39.9 billion in 2020 and PLN 30.5 billion in 2019,
- Supplementary Benefit programme for persons unable to live independently worth, according to preliminary data, PLN 3.3 billion, paid from the Solidarity Fund,
- Mama 4+ program addressed to women who have given birth and raised four or more children and do not receive an old-age pension or receive it in an amount lower than the minimum old-age pension, cost approx. at PLN 0.5 billion,
- the total cost of Pension plus programme – the annual supplementary benefit for old-age, disability and other pensioners, amounted to PLN 11.9 billion, paid from the Solidarity Fund,
- family and care benefits and benefits from the Alimony Fund amounted to PLN 12.4 billion (without contributions),
- Good Start programme with the cost at PLN 1.3 billion (in the following years, its costs are planned at a similar level),
- benefits financed from the State Budget to be paid by the Social Insurance Institution (ZUS) and the Agricultural Social Insurance Fund (KRUS) (among others, benefits for veterans, electricity allowance, coal in-kind allowances, excluding the Mama 4+ programme) amounted to PLN 2.9 billion (in the following years, this cost is expected to be at a similar level),
- social pension and funeral allowance paid from the Solidarity Fund - cost at PLN 4.3 billion. This expenditure will increase in the following years due to the indexation of social pension.

In 2021, an additional annual benefit for old-age, disability and other pensioners, the so-called 14th pension, was also paid in the total amount of PLN 10.4 billion.

In 2021, social transfers, including social security benefits, increased by 8.0% yoy in nominal terms and amounted to 17.9% of GDP, which represents a decrease by 0.8 percentage point in relation to GDP.

In 2021, an increase in public consumption by 9.7% yoy was recorded, which was translated into a decrease by 0.5 percentage point in relation to GDP, i.e. to 18.7%. The decline in public consumption in relation to GDP was mainly due to a significant drop in labour costs – by 0.4 percentage point to 10.5%, while the nominal increase in labour costs amounted to 8.7% yoy (real growth by 3.5% yoy).

General government revenue

In 2021, general government revenues amounted to 42.3% of GDP (an increase by 0.8 percentage points compared to 2020), and its nominal increase was 14.9% compared to 2.7% in 2020.

Taxes

In 2021, in accordance with the ESA methodology, tax revenue amounted to 23.6% of GDP, which represents an increase by approx. 1.6 percentage points compared to 2020. Revenue from taxes related to production and imports increased by 1.2 percentage points, while that from income taxes increased by 0.4 percentage point. In accordance with the ESA methodology, "tax revenue" is a much broader category compared to tax revenue under national law, and includes also various types of compulsory charges with an economic tax nature, e.g. revenue from auctioning off CO_2 allowances and other charges related to environmental protection.

Revenue from VAT increased by PLN 39.2 billion, i.e. 21.1%, as a result of a low benchmark in 2020 and high nominal consumption in 2021, stimulated by postponed consumer demand. In 2021, the main element of the VAT base, i.e. private consumption, recorded a nominal increase of approx. 12%, while in 2020, private consumption was only slightly higher than in 2019.

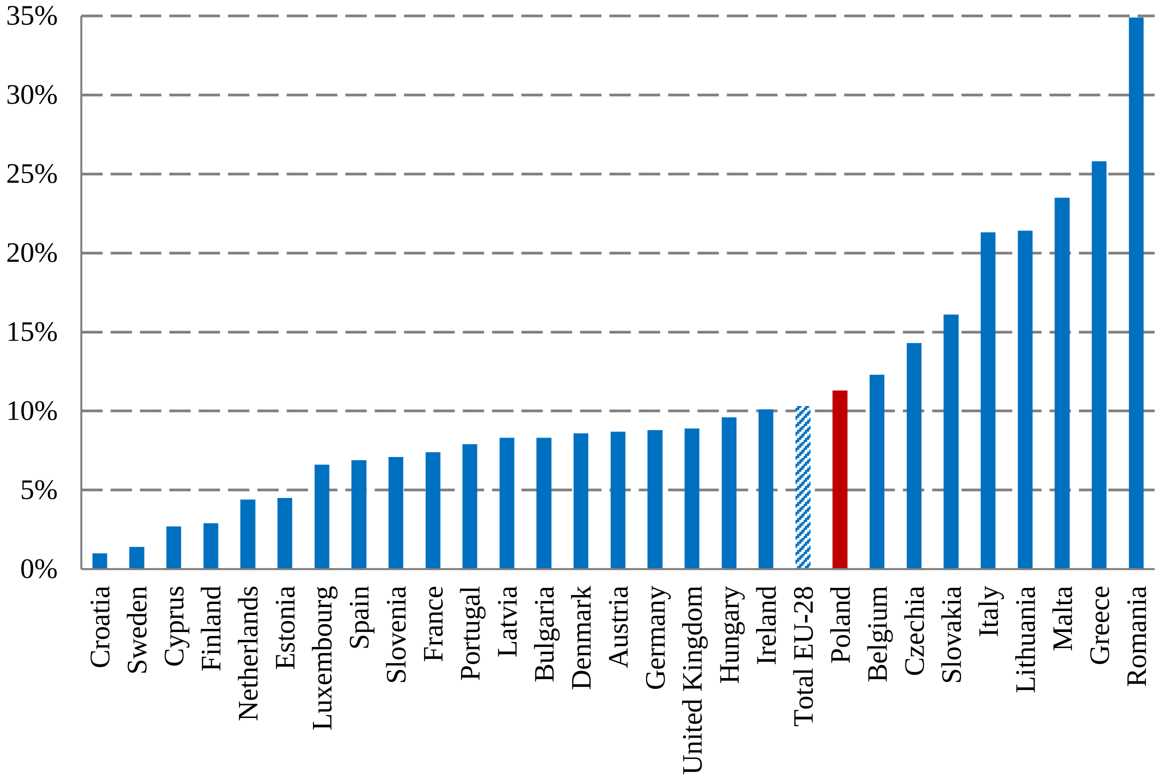
In 2021, revenue from excise duty, including the fuel fee, increased by PLN 6.9 billion, i.e. 8.7% compared to 2020. Excise duty revenue without fuel fee increased by PLN 5.8 billion (8.2%). As in the case of VAT, the high increase in excise duty revenue results from the benchmark effect and the good situation in the economy after months of the lockdown. In 2021, revenue from excise duty on petrol and other motor fuels including the fuel fee increased by 9.3% yoy. Revenue from excise duty on tobacco products increased by 8.8% yoy, and that from excise duty on ethyl alcohol by 4.3% yoy.

In 2021, revenue from personal income tax increased by PLN 17.6 billion, i.e. by 14.6% compared to 2020. It was the result of the improvement in the macroeconomic environment, primarily of the high nominal growth rate of the average wage in the national economy and the high growth rate of nominal GDP. The increase in revenue from PIT in 2021 was also due to the reduced impact of the risks related to the pandemic on the economy. At the same time, changes to the tax system had little impact on revenue from personal income tax. In 2021, the revenue limit entitling entrepreneurs to pay their taxes in the form of lump sum on registered income has been increased from EUR 250,000 to EUR 2 million. However, this policy had only a moderate impact on the personal income tax revenue.

Revenue from CIT increased by PLN 15.9 billion, i.e. 30% compared to 2020, which is also partly due to the benchmark effect, but mainly to the improvement in the economy. In 2021, the financial results of non-financial enterprises were higher than those generated a year earlier. Gross profit was higher by 56.4% higher, and loss was lower by 42%. This revenue was positively affected by covering with CIT limited partnerships, until then subjectively exempt from CIT. Provisions regulating discrepancies in the qualifications of hybrid structures were also introduced.

According to CASE estimates for the European Commission, in 2019[8], the VAT gap in Poland was slightly higher than the European average (see Chart 1).

Figure 1. VAT gap (% of theoretical revenues) in the EU member states in 2019



Source: CASE report for the European Commission, VAT Gap in the EU. Report 2021

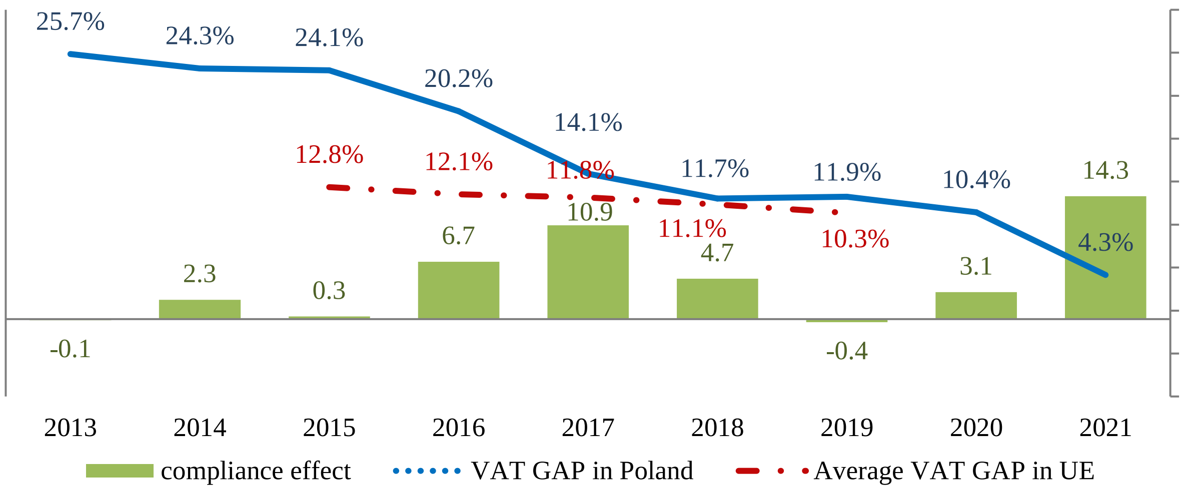
To estimate the VAT gap in 2021, the top-down approach based on macroeconomic data on the VAT base (private consumption, intermediate consumption, general government investment) was used. The current estimates of the VAT gap for 2018-2020 are lower than in the previous update of the Programme.

According to preliminary estimates of the Ministry of Finance[9], in 2021, the VAT gap was further reduced (by 6.1 percentage points) and amounted to approx. 4.3% of potential revenue (see Chart 2). Based on the European Commission's approach to analysing the compliance effect it can be estimated that in 2021, the improvement in VAT revenue due to better compliance with the applicable regulations by taxable persons amounted to PLN 14.3 billion.

[8] For comparison, the estimates from the CASE report for the European Commission (September 2021) regarding the VAT gap in the EU countries were used. For comparative purposes, a percentage ratio that compares the actual VAT revenue with theoretical regulatory revenue is used (VTTL – VAT Total Tax Liability). See VAT Gap in the EU. Report 2021, https://op.europa.eu/en/publication-detail/-/publication/f769dd4a-57da-11ec-91ac-01aa75ed71a1/language-en/format-PDF/source-245971484.

[9] Data for 2019-2021 is preliminary due to the lack of statistical data detailed enough to allow for a full estimate.

Figure 2. VAT gap (in %) and compliance effect (in PLN billion)



Source: estimates of the Ministry of Finance (VAT gap and compliance effect). Data on the average VAT gap in the EU - CASE Report for the European Commission, VAT Gap in the EU. Report 2021

Social security contributions

Revenues from social security contributions were higher by 8.1% yoy (a decrease as the ratio to GDP by 0.6 percentage points to 14.0% of GDP), i.e. below the estimated growth rate of the wage fund in the national economy, which amounted to approx. 9% yoy. The amount of contributions depended on their base, core component of which is the wage fund in the national economy, and, as in 2020, but to a definitely lesser extent, on anti-COVID measures, consisting in the write-off certain social security contributions. At the same time, pursuant to the Act of 2 March 2020 on special solutions related to preventing, counteracting and eliminating COVID-19, other infectious diseases, and emergencies caused by them, as well as certain other acts (Journal of Laws of 2021, item 2095, as amended), such write-off did not jeopardise the continuity of old-age and disability pension rights and retained the right to health and sickness benefits. The redeemed premiums were recorded on an accrual basis in the category of social insurance premiums. In 2021, the value of contributions imputed to the social insurance sub-sector amounted to approx. 0.1% of GDP.

II.3. Medium-term budgetary outlook

Factors determining the general government expenditure

It is expected that in 2022 the general government expenditure in relation to GDP will be at 44.4%. In 2025, it will decrease to 42.2% of GDP, but its level will still be by approx. 0.4 percentage points higher compared to the pre-pandemic level (in 2019, expenditure in relation to GDP was 41.8%).

In accordance with the guidance of the European Commission of March this year, in 2023, expenditure's measures will be aimed at improving its quality and structure, mainly by increasing the financing of investment programmes in the central government sub-sector, including expenditure on the modernisation of the military forces and support for financing investment projects in the local government sub-sector.

Current expenditure

The current expenditure in the forecast period will, to a large extent, result from the continuation of social policy programmes. At the same time, in 2023, in accordance with the guidance of the European Commission (see Chapter II.1), the current expenditure growth rate will be limited.

In 2022, the following programmes and *ad hoc* solutions were introduced in response to the changing environment:

- due to the rising prices of energy, gas and food, the government introduced the so-called Anti-Inflation Shield. One of its key elements is direct support for poorer households in the form of shielding benefit paid in 2022. It is a one-off financial support in the amount depending on the size of the household and meeting the income criterion. The estimated cost of the shielding benefit is approx. PLN 4.7 billion. It is a one-year solution,
- in order to further support families, the Family Care Capital programme was introduced, i.e. a new benefit in the amount of PLN 1,000 PLN monthly paid for a year or PLN 500 monthly paid for two years. The Family Care Capital is available for the second child and subsequent children aged 12 – 35 months in the family. This payment is independent of the family's income. The total cost in the first year of the programme is estimated at approx. PLN 3.0 billion. In 2023, the estimated cost is at PLN 2.4 billion,
- as a result of Russia's aggression against Ukraine, Poland has become a country that hosts a large number of refugees from Ukraine (see Chapter III.1). Therefore, the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state was adopted (Journal of Laws, item 583, as amended). Under this act, Ukrainians residing legally in the territory of the Republic of Poland have been granted the right to, among others, family benefits, child care benefit (500 plus), Good Start benefit and Family Care Capital. Expenditure planned now from the Aid Fund in 2022 for the aforementioned benefits amounts to approx. PLN 4.4 billion, and the total expenditure is approx. PLN 11 billion. These figures may be, however, updated.

In 2022, an additional annual cash benefit is planned for old-age, disability and other pensioners. Approximately PLN 11.2 billion will be allocated for this purpose in 2022.

In 2022-2026, the following benefits will continue to be paid:

- 13th pension for which PLN 12.7 billion from the Solidarity Fund will be allocated in 2022. In the following years, the total cost of the 13th pension will increase from PLN 14.1 billion in 2023 to PLN 16.4 billion in 2026, as a result of an increase in the average old-age, disability and other pensions and indexation,
- 500 plus benefit in the amount of approximately PLN 38.7-40.5 billion per annum,
- family benefits and benefits from the Alimony Fund in the amount of approx. PLN 12.6-13.4 billion per annum.

The mentioned above amounts of the 500 plus benefit and other family benefits do not include payments under the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state.

Public investment

Public investment is part of the strategy to overcome the negative effects of the COVID-19 pandemic. It is expected that in 2022, after a real decline in 2021, a gradual recovery of general government investment will be in place. The investment level in relation to GDP will increase to approx. 4.2% and will remain at this level on average in 2023–2025. The general government investment will depend on multi-annual government programmes, flows from EU budget under multi-annual financial framework for 2014-2020, multi-annual financial framework for 2021-2027, as well as instruments supporting local governments introduced by the government.

Investment tasks in the central government sub-sector will be implemented, among others, as part of the following previously established multi-annual programmes:

- National Road Construction Programme for 2014-2023 (with a view to 2025), financed mainly by the National Road Fund, EU funds and the state budget (currently there are works on the

Government Programme for the Construction of National Roads until 2030 (with a view to 2033), and on the Programme on Strengthening the National Road Network until 2030),

— Programme for the Construction of 100 Ring Roads for 2020-2030 that defines investment objectives and priorities with respect to the construction of city ring roads within the national road network,

— Safe Road Infrastructure Programme for 2021-2024,

— National Road Safety Programme for 2021-2030,

— National Railway Programme until 2023, covering capital expenditures on the construction and modernisation of railway network, carried out by PKP Polskie Linie Kolejowe S.A. and financed by the Railway Fund, the state budget, EU funds, own funds of PKP PLK S.A., and complementary programmes, such as:

  ➢ Railway Station Investment Programme for 2016–2023,

  ➢ Programme to Supplement Local and Regional Railway Infrastructure – Railway+ until 2028,

  ➢ Government Programme to Construct or Modernise Railway Stops for 2021–2025;

— Solidarity Transport Hub Investment Programme. Stage I. 2020-2023. This stage shall include the preparatory works and purchase of land intended for this investment. In the following years, the Solidarity Transport Hub and auxiliary investments: new railway network, including high speed rail, and road projects will be implemented,

— Government Programme to Supplement Local and Regional Road Infrastructure – Bridges for Regions.

Apart from infrastructure programmes, investment in the central sub-sector will be significantly affected by programmes aimed at modernising the military forces. The Act of 11 March 2022 on the defence of the Homeland (Journal of Laws, item 655) has visibly increased expenditures on national Defence – from the planned 2.2% of GDP in 2022 to 3% of GDP from 2023. In order to finance multi-annual programmes to increase Poland's military potential, a Military Forces Support Fund will be established at Bank Gospodarstwa Krajowego.

Investment projects implemented by local government units (LGU) will be supported with funds from the following government programmes:

— Government Local Investment Fund established in 2020. Non-refundable support for LGUs' investment spending of approx. PLN 13 billion was provided to local governments in 2020-2021, including communes where the liquidated state agricultural enterprises used to operate, as well as "mountainous" communes to support investment in public tourist infrastructure and municipal infrastructure related to tourist services,

— Government Programme for Strategic Investments established in 2021, financed from the COVID-19 Counteracting Fund. The Fund provides non-returnable co-financing for investment projects carried out by local government units or their associations. The level of co-financing reaching up to 95% of the project value depends on the area of the economy (the higher the priority, the lower own contribution to the project required from the local government unit). Supported areas include construction or modernisation of road infrastructure, construction or modernisation of water and sewage infrastructure, zero-emission heat sources, construction or modernisation of waste management infrastructure, renewable energy sources, zero-emission transport, electricity infrastructure, digitisation of public and municipal services, revitalisation of urban areas, cultural and tourist or sports infrastructure.

Support for local government units with funds from the above mentioned programmes will stimulate their capital expenditure in new projects. It should also reduce the risk of postponing or resigning from already planned projects due to the lack of financing. The recent changes in the revenue of local government units are an additional factor stimulating investment by local governments. The amendment to the Local Government Income Act[10] introduced a new part of the general subsidy – dedicated for development that should provide constant support for investment projects managed by local governments. The algorithm for calculation of the development part of the general subsidy takes into account the number of inhabitants, as well as the level and changes in capital expenditure per capita of a given local government, compared to the corresponding data for the entire country.

Factors determining the general government revenue

The general government revenue is determined mainly by revenue from taxes and social security contributions. In 2022-2025, the general government revenue in relation to GDP will drop from 40% to 39.7%. The decrease in taxes will be mainly due to the effects of changes introduced in personal income tax.

Taxes

Tax revenue is determined by its base, above all the nominal levels of: private consumption, public investment, income from work, pensions and corporate profits. Over the forecast horizon, the level of tax revenue will be affected, among others, by changes introduced in previous years and continued changes aimed at further tightening of the tax system – mainly in the area of CIT and VAT.

The tax changes introduced in2022 will have the greatest impact on personal income tax revenue. At the beginning of the year, the tax-free threshold was significantly increased for taxpayers paying their taxes in the form of tax scale (the previously regressive tax-free amount was replaced with the fixed tax-free amount of PLN 30,000). The income threshold above which taxpayers are subject to the higher marginal tax rate of 32% was also increased – to PLN 120,000 (previously PLN 85,528). The so-called tax relief for the middle class, reducing the tax base for taxpayers with income ranging from PLN 68,412 to PLN 133,692 per year, was also introduced. However, it is no longer possible to deduct a part of the health insurance premium paid from the calculated tax amount. From the second half of the year, in accordance with the proposed amendments to the provisions on personal income tax, a reduction in the first tax rate is planned (from 17% to 12%). This solution will be introduced at the expense of the abovementioned middle class tax relief. At the same time, a partial deduction of health insurance premiums will be made possible again for entrepreneurs paying their taxes in the form of the 19% flat tax rate, lump-sum income tax or tax card. All these changes significantly reduce the projected PIT revenue in 2022 and in the following years.

At the beginning of 2022, a number of new tax reliefs came into force, including a relief for people coming to Poland from abroad (the so-called return relief), a relief for taxpayers raising at least four children and a relief for working pensioners. All these reliefs provide for exemption from tax of most of the income generated by the above-mentioned social groups. As for CIT, these include: changes in lump-sum taxation of income generated by capital companies, changes to ease the requirements regarding the establishment and operation of tax capital groups, as well as enabling the deduction of the cost of the Initial Public Offering.

New solutions supposed to have a positive impact on the revenue of the public finance sector by tightening the CIT system were also introduced, including:

- minimum tax,
- limiting income transfers and limiting the overestimation of tax deductible costs, e.g. by abolishing the tax neutrality of restructuring transactions where the taxable person overestimates the tax value of assets as a result of transactions and taxing the thus disclosed “hidden reserves”,
- taxation of cross-border transfer of assets also in the case of events such as in-kind contributions or mergers,

[10] Act of 14 October 2021 amending the Act on the income of local government units and certain other acts (Journal of Laws, item 1927, as amended)

- limiting the phenomenon of registering businesses by Polish residents in the territory of another country that do not conduct actual economic operations there,
- eliminating the possibility of obtaining a tax advantage through tax schemes whose purpose is to transfer income to jurisdictions with a negligible effective tax rate.

In 2022, the tax revenue level will also be determined by the introduction of anti-inflation measures. The most important assumptions of Anti-Inflation Shield 1.0 include:

- reduction in the rate of VAT on natural gas from 23 to 8% – from January to March 2022,
- suspension of excise duty on electricity and reduction in the rate of VAT on electricity from 23 to 8% – from January to March 2022,
- reduction in VAT on system heat (heating from radiators) from 23 to 8% – from January to March 2022,
- reduction in the fuel price by maximum reduction in excise tax – until the end of May 2022.

Anti-Inflation Shield 2.0 includes:

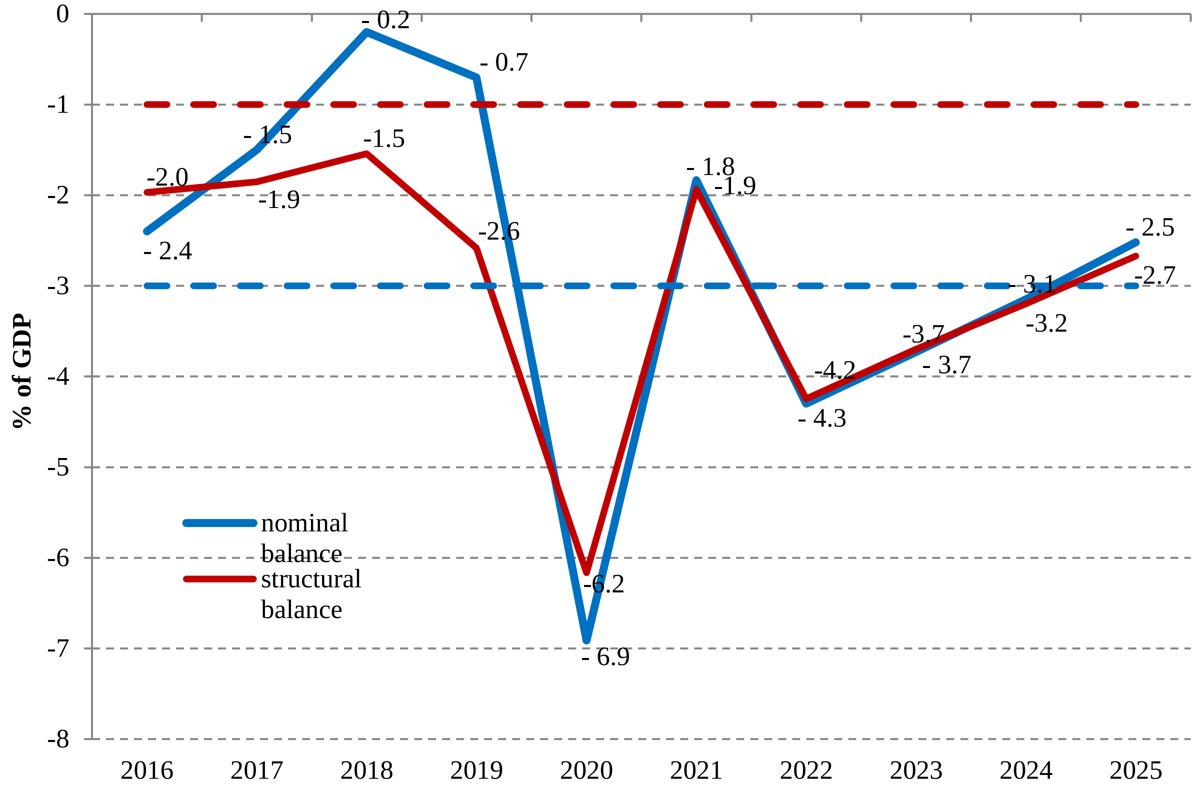
- reduction in VAT on fuel from 23 to 8%,
- prolongation of a 5% VAT rate on electricity,
- reduction in the VAT rate on heat to 5%,
- introduction of a zero VAT rate on fertilisers and other selected agricultural inputs,
- introduction of a zero VAT rate on natural gas,
- introducing a zero VAT rate on basic food products previously subject to a 5% rate.

The tax cuts introduced by Anti-Inflation Shield 2.0 will apply from 1 February for a period of six months, i.e. until the end of July 2022. Due to the continuing high price rate growth, the prolongation of the Anti-Inflation Shields is taken into account. The full-year financial effect of anti-inflation measures in 2022 is estimated at 0.8% of GDP. They will not affect tax revenue in the following years.

Social security contributions

Social security contributions constitute a significant part of general government revenue . In the forecast period, contributions will be determined by macroeconomic factors, in particular the situation on the labour market, and measures taken by the government. Revenues from contributions depend on the base for its calculation, mainly the wage fund in the national economy, but they will also be determined by the effects of systemic changes, in particular in the tax and health contribution system. It is expected that social contributions will amount to 14.0% of GDP in 2022 and will decrease to 13.7% in 2025.

Figure 3. General government balance



Source: Statistics Poland, Ministry of Finance

II.4. Structural balance

The Stability and Growth Pact requires EU Member States to define and reach the so-called medium-term budgetary objective (MTO). Poland has adopted the general government structural deficit at the level of 1% of GDP as its medium-term budgetary objective.

Due to the economic slowdown in the European Union caused by the pandemic, the general escape clause will apply until the end of this year. It allows the Member States to conduct their budgetary policies without having to respect the expenditure benchmark[11]. An annual improvement in the structural balance on the path towards MTO is not required, either.

In 2023, in accordance with the guidance of the European Commission (see Chapter II.1), the current expenditure growth rate should be consistent with the neutral stance of the budgetary policy in the EU as a whole (see Box 1). Therefore, the forecast for 2023 assumes control of the current expenditure growth rate with priority given to capital expenditure. It is assumed that throughout the Programme – in line with the current requirements of the Stability and Growth Pact – the structural deficit will be improving by 0.5 percentage point per annum.

[11] The expenditure benchmark is the maximum EU-allowed annual growth rate of general government expenditure, compliance with which will ensure the accomplishment and maintenance of the MTO.

Table 3. General government structural balance

	% of GDP	2021	2022	2023	2024	2025
1.	**Real GDP growth (%)**	5.9	3.8	3.2	3.0	3.1
2.	**Net lending of general government**	-1.8	-4.3	-3.7	-3.1	-2.5
3.	**Interest expenditure**	1.1	1.7	2.1	2.1	2.1
4.	**One-offs and temporary measures**	0.2	-0.1	0.0	0.0	0.0
4.1	One-offs on the expenditure side: general government	0.2	0.3	0.0	0.0	0.0
4.2	One-offs on the revenue side: general government	0.0	0.4	0.0	0.0	0.0
5.	Potential GDP growth (%)	4.1	3.4	3.3	2.9	2.9
6.	Output gap	-0.2	0.1	0.0	0.1	0.3
7.	Cyclical budgetary component	-0.1	0.0	0.0	0.0	0.1
8.	Cyclically-adjusted balance	-1.7	-4.3	-3.7	-3.2	-2.7
9.	Cyclically-adjusted primary balance	-0.6	-2.7	-1.6	-1.1	-0.5
10.	**Structural balance**	-1.9	-4.2	-3.7	-3.2	-2.7

Source: Ministry of Finance.
* The forecast takes into account the impact of:
- revenue from sales of greenhouse gas emission allowances (one-off measure on the revenue side) - in the years 2021-2022, revenues of PLN 5.3bn and PLN 8.2bn, respectively,
- the cost of assistance to Ukrainian citizens in connection with the armed conflict in that country (one-off measure on the expenditure side) estimated in 2022 at PLN 11.3 bn.

Box 1. Fiscal policy stance

The Stability and Growth Pact does not define a fiscal stance. For several years, the European Commission, in its overviews of stability and convergence programmes, has been analysing the possible aggregate short-term impact on the euro area economy of the implementation by euro area countries of the fiscal policies presented in their stability programmes[12].

The Ecofin Council mentioned the desired fiscal stance for the first time in last year's opinions on the stability and convergence programmes. At that time, it recommended all countries to pursue fiscal policies that support economic growth. This is an "expansionary" fiscal policy stance and, in simplified terms, means that an increase in discretionary spending (i.e. expenditure controlled by the government) compared to the previous year is not offset by an increase in discretionary revenues. The "restrictive" fiscal stance describes the opposite. The "neutral" stance of the budgetary policy means that an increase in discretionary spending is equal to an increase in discretionary revenues.

Due to the extension of the general escape clause in the EU for 2021, the provisions defining the stabilising expenditure rule (SER) continued to be adapted to the challenges posed to the fiscal policy by the COVID-19 pandemic. The Act of 11 August 2021 amending the Public Finance Act and certain other acts extended the period of validity of the return clause and extended the SER to include state special-purpose funds (more information on the changes in Chapter V).

In accordance with the regulations, the return clause will expire at the end of 2022, so will the general escape clause in the EU, and since 2023 the standard SER formula will apply. The preliminary

[12] European Commission, The 2021 Stability and Convergence Programmes: an overview, with an assessment of the euro area fiscal stance, July 2021.

expenditure level for 2023 is estimated at PLN 1,108,866,625 thousand (34.1% of GDP). This amount accounts for discretionary measures on the revenue side in the amount of PLN 9,481,816 thousand. These measures include, among others:

- tax reduction,
- indexation of the rates of excise duty on stimulants,
- introduction of a mobility package,
- updating the effects for previous years:
    - of measures in the VAT compliance area,
    - withdrawal from the tax collection on the written-off subsidies from the Polish Development Fund,
    - solutions to eliminate cases of aggressive tax optimisation.

As a result of the favourable macroeconomic situation, in 2023, the adjustment for public finance imbalance set out in Article 112aa(4) of the Public Finance Act will be 0 percentage points. In 2024-2025, an adjustment of minus 2 percentage points is expected. The amounts of expenditure under the SER in the following years are as follows: PLN 1,167,894,261 thousand in 2024 and PLN 1,219,755,175 thousand in 2025.

However, having regard to the ongoing discussion in the EU on budgetary rules, further adjustments to the SER are possible. As a result, the presented macro-fiscal scenario was developed with the assumption of consolidation at a minimum rate resulting from the Stability and Growth Pact, taking into account the control of current expenditure in 2023 recommended by the European Commission and prioritisation of capital expenditure. It does not, however, assume expenditure limitation implied by the SER.

II.5. General government debt

In the period covered by the Programme, debt management will focus on the achievement of the objective set out in the Public Finance Sector Debt Management Strategy i.e. minimising the long-term debt servicing costs in long-term, subject to the adopted risk constraints.

Debt management will take place in the context of the primary general government deficit , with the nominal deficit at the level of 4.3% of GDP in 2022, systematically reduced to 2.5% until 2025. Uncertainty on financial markets can still occur, as a result of, among others, the geopolitical situation, especially the war in Ukraine, the effects of the refugee crisis, monetary policy, and the growth rate of the world economy, especially in Europe.

Changes in the debt-to-GDP ratio will be primarily a consequence of the borrowing needs of the state budget and funds established at Bank Gospodarstwa Krajowego, as well as the rate of nominal GDP growth. The general government debt-to-GDP ratio is expected to fall to 52.1% in 2022, and then gradually decline, reaching 49.7% at the end of 2025.

The development of the average interest rate on the general government debt will result primarily from the expectations as to the level of interest rates within the time horizon of the Programme and the pace of redemption of debt issued in the past at yields different from the current ones.

Table 4. General government debt (end of the year)

	% of GDP	ESA Code	2021	2022	2023	2024	2025
1.	**Gross debt**		53.8	52.1	51.5	51.0	49.7
2.	**Change in the gross debt ratio**		-3.4	-1.7	-0.6	-0.5	-1.3
	Contributions to changes in gross debt						
3.	**Primary balance***		0.7	2.7	1.6	1.0	0.4
4.	**Interest expenditure**	EDP D.41	1.1	1.7	2.1	2.1	2.1
5.	**Stock-flow adjustment**		-5.2	-6.1	-4.3	-3.6	-3.8

* Impact of primary balance on debt: (-) means primary surplus.
Source: Ministry of Finance.

III. Sensitivity analysis and comparison with the previous update

III.1. Risk factors

The main risk factor for the forecast is the further development of the war in Ukraine and its impact on the domestic and global economy. In the case of a prolonged and worsening conflict, more stringent sanctions on Russia, including an embargo on imports of raw materials by EU countries, are possible. This would worsen the economic outlook for Poland's key trading partners. For example, estimates for Germany indicate that the embargo on Russian energy resources would translate into a decline in GDP by 0.5 to 3.0% (depending on the adopted assumptions and methodology)[13]. It would also likely lead to an increase in global commodity prices above the forecasted prices and thus to a higher projected inflation rate. Similar uncertainty exists with respect to the development of prices of other products exported in large quantities by Russia and Ukraine, e.g. the prices of certain agricultural products.

Another important factor is the impact of the Ukrainian population coming to and leaving Poland. From the beginning of the Russian invasion to the end of March, approx. 2.4 million people crossed the Polish-Ukrainian border entering Poland. The first wave of refugee influx is gradually fading away. At the end of February and in the first half of March, the average daily number of people crossing the border was approx. 100,000, and in the last days of March it dropped to 20,000-30,000. As at 29 March, more than half a million PESEL numbers had been issued, allowing, among others, for taking up work or continuing education. 96.5% of all numbers were issued to women and children. Approximately half of those people were under the age of 18[14]. Since the beginning of the process of issuing PESEL numbers, their daily number did not change significantly and was approx. 50,000 (about half of these numbers were issued for adults). At the same time, since the beginning of the Russian invasion, an increase in the number of people crossings the border towards Ukraine has also been recorded – approx. 400,000 from 24 February to 31 March. These were mostly Ukrainian economic migrants (mainly men) returning to their country to fight against the aggressor.

Uncertainty as to the final number of refugees from Ukraine and the duration of their stay in Poland makes it difficult to estimate the costs of aid for these people. Pursuant to the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state, an Assistance Fund intended, in particular, for financing or co-financing tasks related to assistance to Ukrainian citizens, was established. Some of the activities aimed at supporting people coming from Ukraine will be financed also from other sources (the state budget, the Labour Fund, funds from the Governmental Strategic Reserves Agency, and own budgets of local government units).

During the preparation of the forecast, it was not possible to determine the impact of refugee flows on the labour market. The number of refugees for whom Poland is not a destination is unknown, nor is the number of those who intend to return to Ukraine if the conflict begins coming to an end (and when it might happen). It is also difficult to estimate the rate of professional activity and employment of refugees – those who treat Poland as a temporary shelter or a place of permanent residence. The experiences related to the wave of refugees in Germany in 2015 shows that they are characterised by a rather low employment rate – after two years, it was around 20% and after three years – around 35%[15]. However, this is difficult to compare these situations. In Poland, we are dealing, among others, with: a greater inflow scale, different age and sex structure, greater similarity of the language and culture, and possibly a better network of contacts for many refugees due to earlier migration of Ukrainian citizens. In the short term, there may be significant skills mismatches on the labour market – a decline in labour supply in traditionally male-dominated industries (e.g. construction) and an increase in service sectors (e.g. trade, catering). In the medium and long term, the influx of Ukrainian citizens may have a positive effect,

[13] Bachmann, Ruediger, et al. (2022), What if? The Economic Effects for Germany of a Stop of Energy Imports from Russia, no. 36. ifo Institute-Leibniz Institute for Economic Research at the University of Munich.

[14] https://www.pap.pl/aktualnosci/news%2C1136630%2Cpol-miliona-numerow-pesel-dla-obywateli-ukrainy.html

[15] Brücker, Herbert, et al. (2019), *Second wave of the IAB-BAMF-SOEP Survey: Language skills and employment rate of refugees improving with time*.

partially reducing the negative impact of demographics on the labour supply. Moreover, the increase in the number of Ukrainian economic migrants returning to their country creates problems in some sectors of the economy. In March, there was a significant deterioration in sentiment, among others, in construction and transport, where the rate of employment of Ukrainian migrants before the war was relatively high.

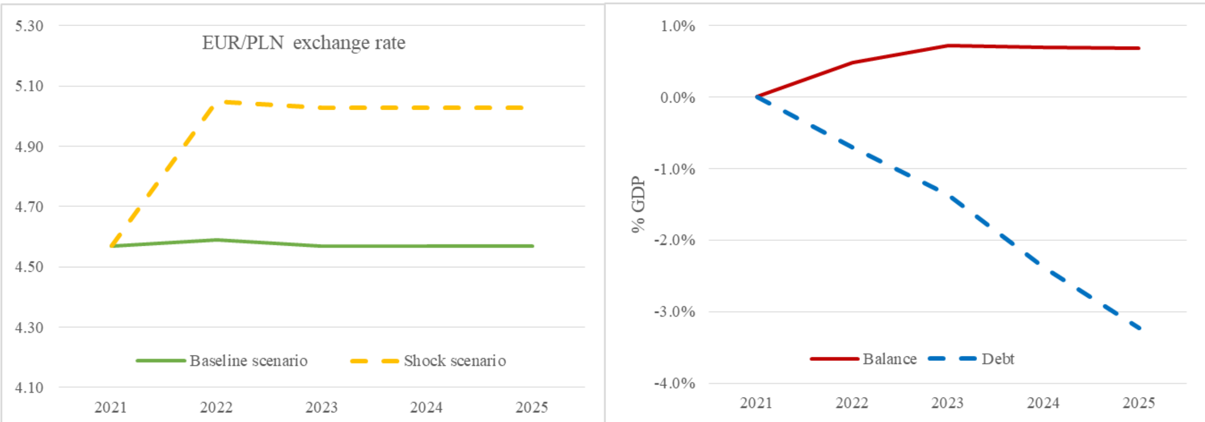
The epidemiological situation is still a risk factor. Despite high vaccination rates in Western European countries, another increase in COVID-19 incidence has been observed in recent weeks. If the latest virus variant reaches the eastern part of the EU, with a lower vaccination rate than in the western part of the continent, it may again place a heavy burden on the health care system and, therefore, necessitate the reintroduction of economic restrictions. Another negative risk factor for the forecast is the longer-than-assumed continuation of obstacles in the global supply chain, likely due to China's zero-COVID policy.

The acceptance by the EU institutions and the implementation of the National Recovery and Resilience Plan (NRRP) is a positive risk factor in relation to the baseline scenario. The Plan provides for the use of funds from the EU Recovery and Resilience Facility by 2026 (see Tables 18-19). The estimates of the effects of the NRRP implementation were taken into in the previous update of the Programme. According to these estimates, in the first three years of using the funds, the real economic growth would be higher by an average of 0.6 percentage points. The implementation of the NRRP would also have positive effects on the labour market – compared to the baseline scenario, 0.3% more jobs would be created within two years.

III.2. Sensitivity analysis

The sensitivity of the general government balance and debt in 2022-2025 to a depreciation of the zloty exchange rate and the increase in the domestic interest rate is presented below. The analysis was performed based on the econometric Model of Public Finance developed by the Ministry of Finance. Simulation results are based on the historical elasticities estimated for the assumed forms of behavioural equations.

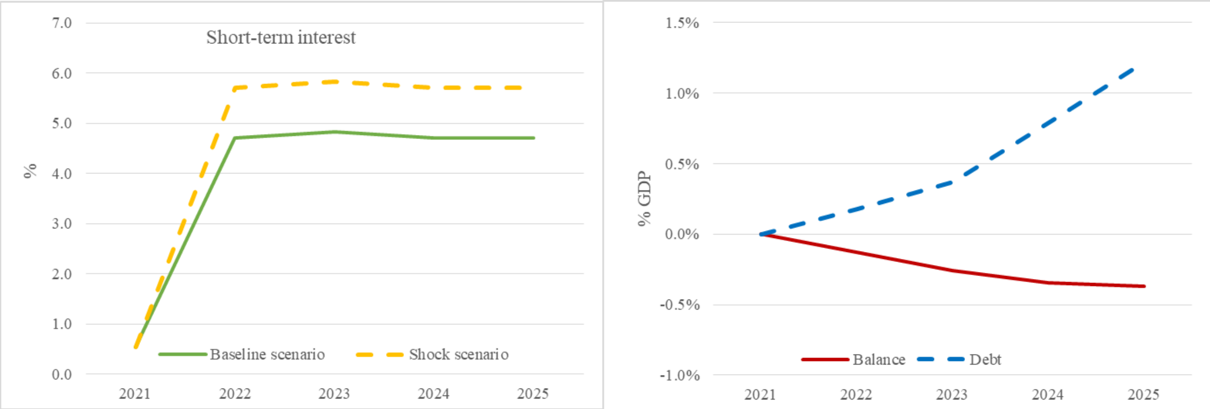
Figure 4. EUR/PLN exchange rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance

The exchange rate impulse (see Chart 4) was introduced as a permanent 10% depreciation of the PLN/EUR exchange rate. The weakening of the zloty improves the competitiveness of domestic products, which directly results in an increase in the volume of exports. The increase in exports due to their high import-intensiveness is accompanied by an increase in imports. An increase in demand for Polish goods fosters the improvement of labour market conditions and an acceleration of investment activity, which supports the GDP growth in the forecast horizon. Higher economic growth leads to an increase in general government revenue that exceeds the increase in expenditure on servicing debt denominated in foreign currencies, ultimately leading to an improvement in the government balance. As a consequence, in the shock scenario, the general government debt in 2025 is lower in relation to GDP than in the baseline scenario.

Figure 5. Short-term interest rate (left chart) and its impact on the general government balance and gross debt (right chart)



Source: Ministry of Finance

The interest rate impulse (see Chart 5) has been defined as an increase in the nominal short-term interest rate by 1 percentage point for the entire period covered by the analysis. A rise in short-term interest rates results in an increase in long-term interest rates and leads to a higher cost of capital acquisition, which limits the investment level against the baseline scenario and increases debt financing. As a result of a shift in consumption over time due to inter-temporal substitution and more stringent conditions for granting loans, the level of private consumption is also decreasing. As a consequence, the impulse triggering the enhancement of monetary policy restrictiveness leads to a decrease in GDP volume in the forecast horizon. Parallel to the growing debt servicing costs and a relatively lower GDP level, the general government balance to GDP ratio deteriorates and the share of the general government debt in GDP grows against the relation in the baseline scenario.

III.3. Comparison with previous update

Real GDP growth in 2021 was higher than assumed in last year's update of the Programme. The better-than-expected balance was supported by the satisfaction of postponed demand by consumers, the improvement in the situation on export markets and the related good results of industrial production, as well as economic entities' adaptation to operating in pandemic conditions. In turn, the planned growth rate in 2022-2024 is lower than in the previous update of the Programme, mainly due to the higher assumed path of NBP interest rates and the negative impact of Russia's invasion of Ukraine on economic activity.

In 2021, the general government deficit amounted to 1.8% of GDP and turned out to be 5.1 percentage points lower than expected. The better general government balance as compared to the forecast from the previous Programme was the result of revenue (mainly from taxes) higher than projected by 0.8 percentage points and expenditure lower by 4.3 percentage points. The main factors determining the reduction in the general government expenditure in 2021 included lower spending on support for entities affected by the COVID-19 pandemic and significantly lower investment activity of general government units. The forecast of deficit for 2022-2024 is higher than in the previous update of the Programme, mainly due to the inclusion the changes in the tax and health contribution system, a package of anti-inflation measures and spending on defense, an additional financial benefit for old-age and disability pensioners, and expenses related to aid for Ukrainian citizens in connection with the military aggression on that country.

The lower general government debt to GDP ratio in 2021 compared to the forecast from the previous Programme resulted mainly from lower borrowing needs of the central government subsector, including state budget expenditure and expenditure under the Financial Shield, as well as higher nominal GDP and the depreciation of the zloty. The lower than previously expected ratio of the general government debt to GDP in the coming years is the result of on one hand higher borrowing needs of the central government subsector and the depreciation of the zloty, on the other hand the assumed much higher nominal GDP level.

Table 5. Differences from the previous update

	ESA Code	2021	2022	2023	2024	2025
Real GDP growth (%)						
2021 Programme		3.8	4.3	3.7	3.5	-
Current update		5.9	3.8	3.2	3.0	3.1
Difference		2.1	-0.5	-0.5	-0.5	-
General government net lending (% of GDP)	EDP B.9					
2021 Programme		-6.9	-4.2	-3.2	-2.5	
Current update		-1.8	-4.3	-3.7	-3.1	-2.5
Difference		5.1	-0.1	-0.5	-0.6	
General government gross debt (% of GDP)						
2021 Programme		60.0	59.2	58.7	57.9	-
Current update		53.8	52.1	51.5	51.0	49.7
Difference		-6.2	-7.1	-7.2	-6.9	-

Source: Ministry of Finance, Statistics Poland

IV. Sustainability of public finances

IV.1. Long-term budgetary prospects, including the implications of ageing population

Sustainable public finance supports long-term economic growth and constitutes a critical element of macroeconomic sustainability. It is therefore necessary to monitor the sustainability of public finance in the short, medium and long term for early identification of any threats and implementation of countermeasures. Therefore, in order to ensure the sustainability of public finance it is necessary to have well-grounded budgetary framework.

The Polish budgetary framework consists of fiscal rules including:

— public debt rules,

— stabilising expenditure rule that has a stabilising effect on public finance in the medium and long term and offsets any imbalances, minimising the risk of over-tightening of budgetary policy,

— rules limiting the growth in debt of local government units.

The outbreak of the COVID-19 pandemic required mobilising additional budgetary measures in order to overcome the health crisis as well as maintain the operation of the state during the pandemic and economic recovery in the post-pandemic period. Therefore, supporting the economy above the expenditure cap resulting from the fiscal rules, including in particular the stabilising expenditure rule, was reasonable. As expected, the improvement in the macroeconomic situation in 2021 was accompanied by the improvement in Poland's fiscal stability.

Russia's invasion of Ukraine and its consequences for the Polish economy pose another challenge to the sustainability of public finance in the coming months. The situation on the other side of the eastern border requires increased public spending on aid for Ukraine and refugees arriving in Poland. Moreover, due to mounting geopolitical tensions, defence spending will increase. These factors will contribute to an increased pressure on Poland's fiscal sustainability.

The European Commission regularly assesses the situation in Member States in terms of public finance sustainability, based on fiscal gap ratios in the medium (S1 indicator), and long, infinite horizon (S2 indicator). The fiscal gap reflects the scale of the necessary adjustments to the primary structural balance adjusted for a cycle's impact, so that the public debt reaches a specific level (S1 indicator), or so that the solvency condition is satisfied in the infinite horizon (S2).

The S1 and S2 indicators make it possible to determine whether the macroeconomic scenario presented in the Programme, assuming control of current expenditure in 2023 and an improvement in the structural balance by 0.5 percentage points per annum, would be sufficient to preserve public finance sustainability in the medium and long term. An increase in the indicator means that a greater improvement in the primary structural balance adjusted for a cycle is required, while its decrease means that public finance sustainability is improving and that the required adjustments to the primary structural balance for a cycle will be lower.

Table 6. Fiscal sustainability indicators in the subsequent periods

	base year 2022	**base year 2025**
S1	2.5 high risk	-0.9 low risk
S2	5.2 medium risk	2.5 medium risk

Remarks: the S1 indicator's value of less than 0 indicates low risk, from 0 to 2.5 medium risk, and above 2.5 high risk. In the case of the S2 indicator, a value lower than 2 indicates low risk, from 2 to 6 medium risk, and above 6 high risk.
Source: Ministry of Finance

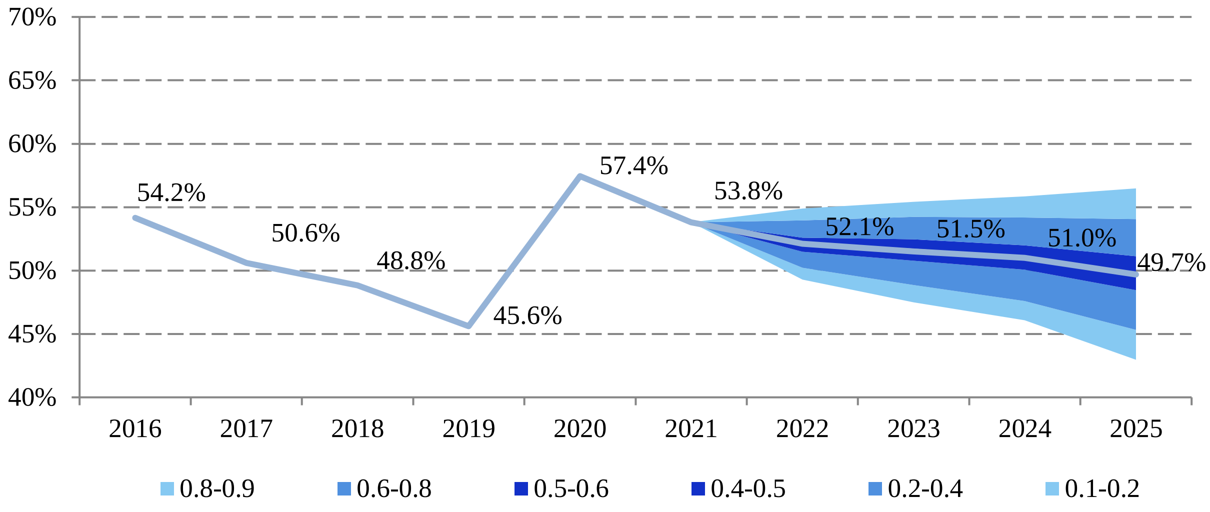
Table 6 presents the S1 and S2 indicators estimated by the Ministry of Finance for the two baseline-year variants. The calculations of the S1 and S2 indicators assume a return to the methodology from 2019, i.e. from before the pandemic. The estimate of the Ministry of Finance is based on the forecasts of macro-fiscal indicators presented in the Programme and the forecast of costs related to the aging of the population, prepared by the Working Group on Ageing Populations and Sustainability (AWG) at the EU Economic Policy Committee and presented later in the chapter.

The fiscal effort made to overcome the health crisis and limit the negative economic effects of the pandemic had a clear negative impact on the S1 and S2 indicators in the last year's update of the Programme. However, due to the improving macroeconomic situation in 2021 and bringing the primary deficit below 3% of GDP, the values of the S1 and S2 indicators improved.

Assuming that the consolidation effort is carried out consistently with the forecast presented in the Programme, it can be expected that the S1 and S2 indicators for Poland will further improve in the coming years. The projected improvement in the primary balance adjusted by a cycle and the decline in public debt reduce the risk to the sustainability of Poland's public finance in the medium term to a low level.

The presented assessment of fiscal sustainability is subject to uncertainty due to the unpredictable impact of Russia's invasion of Ukraine on the Polish economy. However, in view of its good starting position, it should not result in a high risk to the public finance sustainability.

Figure 6. Stochastic debt projections from 2022



Source: Ministry of Finance

The low level of risk to public finance sustainability is also indicated by stochastic debt simulations developed based on the approach applied by the European Commission and the International Monetary Fund[16]. The projections were derived based on the baseline scenario presented in the Programme and using the annual shocks obtained for the following variables: real GDP growth, real effective yield rate of general government debt, the primary balance, and the exchange rate. The performed analysis of 80% of possible debt paths (paths below 10 and above 90 percentile were excluded) demonstrates that even with a significant combination of unfavourable shocks, the general government debt in the forecast horizon would not reach 60% of GDP.

[16] Stochastic projections are developed using the Monte Carlo simulation based on 1,000 draws

Table 7. Long-term sustainability of public finances

% of GDP	2019	2030	2040	2050	2060	2070
Total expenditure						
Of which age-related expenditure	20.1	22.2	22.2	23.0	24.1	24.1
Pension expenditure	10.6	11.0	10.5	10.7	10.8	10.5
Social security pension:	10.6	11.0	10.5	10.7	10.8	10.5
- old-age and early pensions	9.7	10.2	9.7	10.0	10.2	9.9
- other pensions (disability. survivors)	1.0	0.8	0.8	0.8	0.7	0.6
Health care	4.9	6.3	6.7	7.0	7.4	7.4
Long-term care	0.8	1.1	1.5	1.7	2.1	2.4
Education expenditure	3.8	3.8	3.5	3.6	3.8	3.8
Interest expenditure	0.0	0.0	0.0	0.0	0.0	0.0
Total revenue						
Of which from pension contributions	8.4	8.6	8.7	8.7	8.7	8.7
Assumptions						
Labour productivity growth	3.2	3.2	2.2	2.1	1.8	1.5
Potential GDP growth	3.5	2.3	1.4	0.9	1.1	1.0
Participation rate males (aged 20-64)	83.5	84.1	82.6	82.8	83.4	82.9
Participation rate females (aged 20-64)	68.0	69.6	67.2	67.6	69.3	68.5
Total participation rate (aged 20-64)	75.7	76.9	75.0	75.3	76.5	75.9
Unemployment rate (aged 20-64)	3.2	4.9	5.0	5.0	5.0	5.0
Population aged 65+ over total population	17.9	22.8	25.5	30.4	33.9	34.0

Remarks: the calculations were based on the macroeconomic assumptions available at the stage of preparing the report (Aging Report 2021), i.e. from 2020. The report is prepared every 3 years and and its long-term forecasts of age-related expenditure are used until a new report is published.
Source: European Commission and Ageing Working Group (AWG) of the Economic Policy Committee (EPC).

The projections of long-term public expenditure presented in the table have been prepared by the Working Group on Ageing Populations and Sustainability (AWG) at the Economic Policy Committee (EPC). They were published by the European Commission in 2021 in the Ageing Report 2021 on ageing effects foreseen up to 2070. The forecasts were based on demographic assumptions developed by Eurostat, extrapolation of historical trends and technical assumptions regarding the convergence of the basic factors of economic growth, i.e. labour, capital and labour productivity. According to the AWG forecasts, pension expenditure remains stable in the long term and will slightly decline from 10.6% of GDP in 2019 to 10.5% of GDP in 2070. The fluctuations result mainly from changes in the demographic structure of the population. Additionally, the forecast was also influenced by a change in the macroeconomic assumptions. Still, the greatest impact on the expenditure level is exerted by demographic changes. The AWG forecast is designed taking into account the statutory retirement age, while the Polish old-age pension system specifies only the minimum retirement age, and continuation of professional activity results in a significant increase in the amount of future benefits.

Total age-related expenditure is increasing – from 20.1% of GDP to 24.1% of GDP. The increase in this expenditure is mainly due to expenditure on health care and long-term care. The forecast takes into account a gradual increase in expenditure on health care until 2024 to reach 6% of GDP. After the completion of the AWG work on health care forecasts, the Act of 11 August 2021 amending the Act on health care services financed with public funds and certain other acts (Journal of Laws item 1773) came into force. The Act provides for a gradual increase in health care expenditure until 2027, up to 7% of

GDP. It should be emphasised that for organisational reasons (the report is prepared every 3 years) as well as technical ones, incorporating changes in forecasting models requires time and an appropriate procedure[17].

Demographic changes pose a significant challenge to the long-term sustainability of public finance in most European countries. Compared to these countries, the current situation in Poland appears favourable. It should be expected, however, that the ageing of population observed in recent years, caused by the ever longer life expectancy, low fertility rate and the current age structure of population, will continue. As a result, the old-age dependency ratio, i.e. the percentage relationship between the number of people at post-productive age (65 and more) against the number of people at productive age (i.e. aged 20-64), will deteriorate. According to the AWG forecast, this ratio will increase from 29% in 2019 to 67.8% in 2070.

IV.2. Contingent liabilities

The majority of potential contingent liabilities on account of sureties and guarantees results from guarantees granted by the State Treasury in connection with the consequences of the COVID-19 pandemic. These are guarantees of repayment of liabilities from bonds issued by:

- Bank Gospodarstwa Krajowego (BGK) for the purposes of the COVID-19 Counteracting Fund,
- Polski Fundusz Rozwoju S.A. (PFR) to support the economy under the so-called financial shields.

In subsequent years, potential contingent liabilities on account of sureties and guarantees granted by the State Treasury are expected to increase, due to, among others, continuation of support for the economy with the use of COVID guarantees. It is also expected that granting State Treasury sureties and guarantees in order to support investments will continue. These will be mainly investment fostering development of road and rail infrastructure. It is also possible to grant sureties and guarantees for other purposes permitted by the Act, in particular as regards support for: environmental protection, job creation, innovation, regional development, entrepreneurship, and programmes or projects under the EU assistance programmes. These sureties and guarantees will be mainly granted for investment co-financed by EU funds (loans and bonds underwritten or guaranteed by the State Treasury should enable the acquisition of EU funds), as well as for other investment tasks arising from any support programmes stipulating granting sureties and guarantees.

An increase in potential liabilities due to sureties and guarantees will also result from granting new types of guarantees. These concern measures in line with:

- the Act of 26 January 2022 on special solutions to protect consumers of gaseous fuels in connection with the situation on the gas market (Journal of Laws, item 202) – State Treasury guarantees securing financial liabilities for gas sellers in order to obtain funds to guarantee continuity of gaseous fuel supplies; the Act provides that such guarantees may be granted until 1 January 2026, in a total maximum amount of PLN 30 billion,
- the Act of 12 March 2022 on assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state – State Treasury guarantees securing liabilities under bonds issued by BGK to feed the Assistance Fund,
- the Act of 11 March 2022 on the defence of the Homeland – State Treasury guarantees securing liabilities under bonds issued by BGK to supply the newly created Armed Forces Support Fund, as one of the elements of the new mechanism for long-term financing of the country's defence needs

[17] The forecasts of expenditure on health care and long-term care presented in the table, in accordance with the methodology of work adopted by the Working Group, are developed by the European Commission. The amended Act, i.e. adopting the expenditure level of 7% of GDP, will be included in the forecasting models in the next edition of the AWG.

(no sufficient data on potential amounts of these guarantees is currently available and these guarantees were not included in the forecast).

It is estimated that the ratio of potential liabilities to GDP may increase in 2022 by 2.4 percentage points compared to the situations as at the end of 2021 when this figure was 13.7%.

Table 8 includes only guarantees granted by the State Treasury. Contrary to the previous Programme, instead of taking into account the maximum planned amounts for 2020 and 2021, the implementation of support for these years and the projected amounts for 2022 were taken into account. As there is no typical cap on potential guarantee liabilities, the column with the maximum amounts of liabilities has not been filled in. These are identical to the current forecasts.

The other guarantees presented in the table include projected "non-COVID" guarantees that typically support non-COVID-19 investment and incorporate some of the new types of guarantees listed above.

Table 8. Government COVID-19-related guarantees and others

	Measures	Date of adoption	Maximum amount of contingent liabilities (% of GDP)	Estimated take-up (% of GDP)
	In response to COVID-19:			
1.	State Treasury guarantees related to the issue of bonds by the Polish Development Fund	April 2020	n.a.	2.9
2.	State Treasury guarantees for BGK's liabilities incurred for the purposes of the COVID-19 Counteracting Fund	March 2020	n.a.	7.2
	Subtotal		n.a.	10.1
	Others:			
1.	Other guarantees		n.a.	6.0
	Subtotal		n.a.	6.0
	Total			**16.1**

Source: Ministry of Finance.
Remarks: the table shows the potential liabilities as forecasted at the end of 2022 (e.g. due to the forecasting of further support from the COVID-19 Counteracting Fund in 2022).

Currently, no State Treasury expenditure is anticipated for the guarantee activation. The long-term risk ratio for the portfolio of sureties and guarantees granted by the State Treasury should remain at a low level. As for guarantees relating to the COVID-19 epidemic, the projected payments amount to zero due to the adopted mechanisms of providing the PFR and the COVID-19 Counteracting Fund at BGK with funds to repay the guaranteed liabilities. No expenditure of this type has been made so far.

V. Institutional features of public finances

The Ministry of Finance continues the budgetary system reform (BSR). Its main objective is to implement a budgetary system supporting the delivery of strategic objectives and development priorities in long-term perspective. Specific objectives include, among others:

- introduction of a medium-term budgetary framework (MTBF) and integration of multi-annual and annual planning processes,
- introduction of a new budgetary classification,
- improvement of data collection systems (budgetary reporting and financial reporting),
- institutionalisation and inclusion of spending reviews and other instruments enhancing the efficiency of public spending into the budgetary process.

The objectives and directions of the BSR address the Council Recommendation of 9 July 2019. The Council of European Union recommended taking further steps to increase the efficiency of public spending, including by improving the budgetary system in Poland.

Given the interdependencies between the components of the budgetary system reform, the development of a Standardised Chart of Accounts (SCoA), integrated with the budgetary classification was prioritised. This project is carried out jointly with the International Monetary Fund. The publication of the SCoA concept note[18] concluded the stage of basic conceptual works and enabled to initiate consultations of the proposed solutions with external stakeholders. The actual implementation steps will be preceded with desk reviews and then pilots in real world environment.

In 2021, the realization of spending reviews was completed in the following areas: (1) determining the wages for the state budgetary employees – stage II, and (2) supporting employment and counteracting unemployment. The Ministry of Finance obtained further funds from the Technical Support Instrument for expert support in the conducting of two pilot spending reviews – in accordance with the changed rules – in the area of health and supporting small and medium-sized enterprises. The reviews are carried out with the support of OECD experts. OECD experts also provided support in developing the concept of institutionalisation of spending reviews and their inclusion in the budgetary process.

Simultaneously, the conceptual works on the institutionalisation of the medium-term budgetary framework in the Public Finance Act are carried out. Legal and institutional solutions that will enable the preparation of the state's consolidated financial statement are also being developed.

The implementation of the budgetary system reform is one of the elements of the reform of the fiscal framework included in the National Recovery and Resilience Plan. Its second element is the reform of the stabilising expenditure rule. In line with the National Recovery and Resilience Plan, last year's amendment to the Public Finance Act[19] extended the scope of this rule to include state special purpose funds. Including a larger number of general government units in the scope of the rule, while maintaining its operability, will increase the transparency and efficiency of public finance management.

In order to ensure adequate support for the Polish economy facing the pandemic, the provisions of the Public Finance Act[20] concerning the Stabilising Expenditure Rule (hereinafter referred to as "SER") were adjusted twice. These changes were in line with the EU general escape clause. The first adjustment to the Public Finance Act introduced by the Act of 28 May 2020 amending the Public Finance Act made allowed to temporarily suspend the SER and apply the escape clause if the government announces an epidemic throughout the country and the economic situation deteriorates significantly. A return clause

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[18] Cf. https://www.gov.pl/web/finanse/reforma-systemu-budzetowego

[19] Act of 11 August 2021 on the amendment to the Public Finance Act and certain other acts

[20] Act of 28 May 2020 on the amendment to the Public Finance Act (Journal of Laws, item 1175) and

Act of 11 August 2021 on the amendment to the Public Finance Act and certain other acts was also introduced to enable an automatic, gradual return to the original SER formula. Due to the fulfillment of the statutory conditions in the amendment to the Budget Act for 2020[21], the application of the SER was suspended.

Following the extension of the general escape clause validity until the end of 2022, another amendment to the Public Finance Act was introduced to further support the economy. The amendment to Article 112d of the Public Finance Act, concerning the SER escape and return clauses and the calculation of the standard SER formula (Article 112aa of the Public Finance Act), concerned in particular:

- modification of the criteria for returning to the original SER formula; introducing uniform criteria determining the duration of the return clause validity, consisting in comparing, in the years when the return clause is in force, the average real economic growth rate in the year of the escape clause application and in the years of the return clause application against the indicator of the medium-term growth rate of the value of GDP in constant prices from before the pandemic (the indicator of the medium-term GDP growth rate normally used in the SER formula). The proposed amendment allowed for consistency with the general EU escape clause, while simplifying the mechanism,
- eliminating disruptions caused by the effects of the pandemic from the medium-term GDP growth rate in constant prices, determining the amount of expenditure. The actual annual economic growth rate in constant prices in the years when the escape and return clauses apply is replaced – when calculating the indicator – with the average real economic growth from before the SER suspension (the indicator of medium-term GDP growth rate in constant prices specified in the draft budget act preceding the year of the escape clause). The lack of such adjustment would mean a permanent impact of the shock caused by the pandemic on the path of expenditure covered by the SER,
- not including, in the years when the escape and return clauses were applied, adjustments, including those aimed at consolidation of public finance (Article 112d (7) and (8) of the Public Finance Act) – during the period of the existence of circumstances allowing for the application of the escape clause and immediately afterwards, macroeconomic policy should focus on the recovery of the economic potential. Consolidation should only begin after the situation has stabilised.

[21] Act of 28 October 2020 on the amendment to the Budget Act for 2020 (Journal of Laws item 1919)

Table annex

Table 9. Macroeconomic prospects

	ESA Code	2021 Level	2021 Rate of change	2022 Rate of change	2023 Rate of change	2024 Rate of change	2025 Rate of change
1. Real GDP (PLN billion)	B1*g	2478.0	5.9	3.8	3.2	3.0	3.1
2. Nominal GDP (PLN billion)	B1*g	2622.2	12.1	12.1	10.5	7.7	6.7
			Components of real GDP				
3. Private consumption expenditure	P.3	1404.2	6.0	5.9	4.0	2.7	2.9
4. Government consumption expenditure	P.3	461.2	3.4	1.2	2.3	2.1	2.1
5. Gross fixed capital formation	P.51	418.3	3.8	4.8	4.0	2.5	2.7
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	64.1	3.8	3.3	2.3	2.3	2.3
7. Exports of goods and services	P.6	1461.7	11.8	4.5	4.0	3.6	3.6
8. Import of goods and services	P.7	1331.5	15.9	4.1	3.1	2.9	2.9
			Contributions to real GDP growth				
9. Final domestic demand		-	7.1	3.4	2.5	2.4	2.6
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	2.4	-0.9	-0.9	0.0	0.0
11. External balance of goods and services	B.11	-	-1.2	0.4	0.7	0.6	0.5

Source: Ministry of Finance
Remark: the levels of real volumes are expressed in constant prices of 2021.

Table 10. Price developments

	ESA Code	2021 Level	2021 Rate of change	2022 Rate of change	2023 Rate of change	2024 Rate of change	2025 Rate of change
1. GDP deflator		-	5.8	8.0	7.1	4.6	3.5
2. Private consumption deflator		-	5.4	9.4	8.0	4.8	3.7
3. HICP		-	5.2	9.1	7.8	4.8	3.5
3a. CPI		-	5.1	9.1	7.8	4.8	3.5
4. Public consumption deflator		-	6.0	8.5	7.0	5.3	4.0
5. Investment deflator		-	3.8	7.1	5.7	4.0	2.0
6. Export price deflator (goods and services)		-	9.0	8.9	6.4	4.0	2.8
7. Import price deflator (goods and services)		-	10.7	11.4	6.8	4.2	2.8

Source: Ministry of Finance, Statistics Poland.

Table 11. Labour market developments

	ESA Code	2021 Level	2021 Rate of change	2022 Rate of change	2023 Rate of change	2024 Rate of change	2025 Rate of change
1. Employment (thousands of persons)*		16 656	2.6	1.2	-0.1	-0.1	-0.3
2. Employment (hours worked)**		-	-	-	-	-	-
3. Unemployment rate (%)***		3.4	3.4	2.7	2.6	2.6	2.6
4. Labour productivity (PLN thousand)****		148.8	3.3	2.6	3.2	3.1	3.4
5. Labour productivity (PLN thousand)*****		-	-	-	-	-	-
6. Compensation of employees (PLN billion)	D.1	1 005.6	8.9	11.6	10.0	8.2	6.8
7. Compensation per employee (PLN thousand)		75.2	-	10.3	10.1	8.3	7.1

* Average employment based on LFS (aged 15-89).
** National accounts definition.
*** Harmonised unemployment rate, Eurostat definition, levels.
**** Real GDP per person employed.
***** Real GDP per hour worked.
****** No calculation the growth rate in 2021 due to changes in LFS (from 2021).
Source: Ministry of Finance, Statistics Poland.

Table 12. Sectoral balances

% of GDP	ESA Code	2021	2022	2023	2024	2025
1. Net lending / borrowing vis-à-vis the rest of the world*	B.9	1.0	-0.1	0.6	0.4	1.2
of which: - balance on goods and services		4.5	3.5	3.8	4.1	4.4
- balance of primary incomes and transfers		-5.1	-5.0	-4.8	-4.6	-4.4
- capital account		1.6	1.4	1.6	0.9	1.1
2. Net lending/borrowing of the private sector	B.9	2.8	4.2	4.3	3.5	3.7
3. Net lending/borrowing of general government	EDP B.9	-1.8	-4.3	-3.7	-3.1	-2.5
4. Statistical discrepancies		-	-	-	-	-

* Balances level in line with the balance of payments statistics. Net lending/borrowing vis-a-vis the rest of the world is equal to sum of capital and current account.
Source: Ministry of Finance, Statistics Poland

Table 13. Basic assumptions

	2021	2022	2023	2024	2025
Short-term interest rate (annual average)	0.5	4.7	4.8	4.7	4.7
Long-term interest rate (annual average)	1.9	5.3	5.4	5.3	5.3
Nominal effective exchange rate	-	-	-	-	-
Exchange rate vis-à-vis the EUR (annual average)	4.57	4.59	4.57	4.57	4.57
World excluding EU. GDP growth **	5.8	3.2	3.8	-	-
EU GDP growth **	5.3	3.0	2.8	-	-
Growth of relevant foreign export markets *	9.3	5.1	5.2	-	-
World import volumes**	10.4	4.5	4.6	-	-
Oil prices (Brent, USD/barrel)	70.7	98.2	90.0	90.0	90.0

* As an indicator of the foreign export markets.
Source: Ministry of Finance, except for the positions marked **, for which the source is the European Commission, European Economic Forecast. Winter 2022, February 2022 (data for 2022 have been adjusted for the expected impact of the war in Ukraine).

Table 14. General government budgetary prospects

	ESA Code	2021 PLN million	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP
Net lending (EDP B9) by sub-sector							
1. General government	S.13	-48 105	-1.8	-4.3	-3.7	-3.1	-2.5
2. Central government	S.1311	-49 598	-1.9	-3.7	-3.3	-2.9	-2.3
3. State government	S.1312						
4. Local government	S.1313	15 913	0.6	-0.1	-0.1	-0.1	-0.1
5. Social security funds	S.1314	-14 420	-0.5	-0.5	-0.3	-0.1	-0.1
General government							
6. Total revenue	TR	1 110 206	42.3	40.0	39.9	39.7	39.7
7. Total expenditure	TE	1 158 311	44.2	44.4	43.6	42.8	42.2
8. Net lending/borrowing	EDPB.9	-48 105	-1.8	-4.3	-3.7	-3.1	-2.5
9. Interest expenditure	EDPD.41	29 087	1.1	1.7	2.1	2.1	2.1
10. Primary balance		-19 018	-0.7	-2.7	-1.6	-1.0	-0.4
11. One-off and other temporary measures*		.	0.2	-0.1	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (=12a+12b+12c)		618 529	23.6	21.9	22.1	22.0	22.0
12a. Taxes on production and imports	D.2	398 812	15.2	14.5	15.1	14.8	14.7
12b. Current taxes on income, wealth, etc	D.5	219 292	8.4	7.3	7.0	7.1	7.2
12c. Capital taxes	D.91	425	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	366 727	14.0	14.0	13.8	13.8	13.7
14. Property income	D.4	16 097	0.6	0.5	0.4	0.4	0.4

	ESA Code	2021 PLN million	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP
15. Other		108 853	4.2	3.6	3.5	3.5	3.6
16. Total revenue	TR	1 110 206	42.3	40.0	39.8	39.7	39.7
Tax burden (D.2+D.5+D.61+D.91-D.995)		981 761	37.4	35.7	35.8	35.7	35.5
Selected components of expenditure							
17 Compensation of employees + intermediate consumption	D1+P2	432 075	16.5	16.3	16.1	16.1	16.1
17a. Compensation of employees	D.1	276 479	10.5	10.2	10.1	9.9	9.9
17b. Intermediate consumption	P.2	155 596	5.9	6.1	6.1	6.2	6.2
18. Social payments (18=18a+18b)		469 906	17.9	17.6	16.8	16.9	16.8
***of which* Unemployment benefits**		2 810	0.1	0.1	0.1	0.1	0.1
18a. Social transfers in kind supplied via market producers	D.6311 D.63121 D.63131	50 317	1.9	1.8	1.8	1.8	1.8
18b. Social transfers other than in kind	D.62	419 589	16.0	15.8	15.0	15.1	15.0
19. Interest expenditure	EDP D.41	29 087	1.1	1.7	2.1	2.1	2.1
20. Subsidies	D.3	31 207	1.2	0.6	0.4	0.4	0.4
21. Gross fixed capital formation	P.51	107 453	4.1	4.2	4.3	4.2	4.2
22. Capital transfers	D.9	29 255	1.1	1.4	1.2	0.9	0.8
23. Other		59 328	2.3	2.6	2.6	2.2	1.8
24. Total expenditure	TE	1 158 311	44.2	44.4	43.6	42.8	42.2
p.m.: Government consumption (nominal)	P.3	489 047	18.7	18.3	18.1	18.0	18.0

* In the years 2021-22, revenues from the sale of additional CO^2 emission rights in the amount of PLN 5.3 bn and PLN 8.2 bn, respectively, has been taken into account. In 2022 – also the cost of assistance to Ukrainian citizens in connection with an armed conflict in the territory of that state, estimated at PLN 11.3 bn.
Source: Ministry of Finance, Statistics Poland.

Table 15. No-policy change projections

	2021 PLN million	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP
1. Total revenue at unchanged policies	1 088 273	41.5	41.1	39.5	39.4	39.6
2. Total expenditure at unchanged policies	-	-	-	-	-	-

Source: Ministry of Finance

Table 16. Amounts to be excluded from the expenditure benchmark

	2021 PLN million	2021 % of GDP	2022 % of GDP	2023 % of GDP	2024 % of GDP	2025 % of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	33 478	1.3	1.0	0.9	0.8	0.9
1a. of which investment fully matched by EU funds revenue	28 033	1.1	0.8	0.8	0.6	0.7
2. Cyclical unemployment benefit expenditure*	-502	0.0	0.0	0.0	0.0	0.0
3. Effect of discretionary revenue measures	21 933	0.8	-1.1	0.4	0.3	0.1
4. Revenue increases mandated by law						

* Estimation of cyclical unemployment expenditure is based on expenditure code D.62 and code D.63 in COFOG function, code 10.5. They cover expenditure exclusively related to social protection in the form of a cash benefit and a benefit in kind paid to households.
The basis for calculating cyclical unemployment expenditure is the unemployment expenditure included in COFOG function, code 10.5. The European Commission has left it up to the Member States to exclude from this function expenditure which in their opinion does not reflect the unemployment expenditure resulting from the cycle. Such situation occurs in case of Poland. Labour Fund expenditure represents the vast majority of expenditure in the COFOG function, code 10.5. At the same time, due to the changing role and tasks of the Fund, there is no justification for using all expenditures included in the COFOG function, code 10.5 as a basis for estimating cyclical unemployment expenditure.
Source: Ministry of Finance

Table 17. General government expenditure by function

% of GDP	COFOG Code	2020	2025*
1. General public services	1	4.4	
2. Defence	2	1.7	
3. Public order and safety	3	2.3	
4. Economic affairs	4	9.1	
5. Environmental protection	5	0.6	
6. Housing and community amenities	6	0.5	
7. Health	7	5.4	
8. Recreation, culture and religion	8	1.3	
9. Education	9	5.2	
10. Social protection	10	18.1	
11. Total expenditure	TE	48.4	42.2

* Expenditure's disaggregation by function is a part of the budgetary process.
Source: Ministry of Finance.

Table 18. Table on the RRF - LOANS

Cash flow from RRF loans projected in the programme (% of GDP)	2020	2021	2022	2023	2024	2025	2026
Disbursements of RRF loans from EU							
Repayments of RRF loans to EU							

Expenditure financed by RRF loans (% of GDP)	2020	2021	2022	2023	2024	2025	2026
Compensation of employees D.1							
Intermediate consumption P.2							
Social payments D.62+D.632							
Interest expenditure D.41							
Subsidies, payable D.3							
Current transfers D.7							
TOTAL CURRENT EXPENDITURE			**0.0**	**0.1**	**0.1**	**0.2**	**0.0**
Gross fixed capital formation P.51g							
Capital transfers D.9							
TOTAL CAPITAL EXPENDITURE			**0.0**	**0.1**	**0.3**	**0.4**	**0.1**

Other costs financed by RRF loans (% of GDP)	2020	2021	2022	2023	2024	2025	2026
Reduction in tax revenue							
Other costs with impact on revenue							
Financial transactions							

Source: Ministry of Development Funds and Regional Policy.

Table 19. Table on the RRF - GRANTS

Revenue from RRF grants (% of GDP)	2020	2021	2022	2023	2024	2025	2026
RRF grants as included in the revenue projections							
Cash disbursements of RRF grants from EU							

Expenditure financed by RRF grants (% of GDP)	2020	2021	2022	2023	2024	2025	2026
Compensation of employees D.1							
Intermediate consumption P.2							
Social payments D.62+D.632							
Interest expenditure D.41							
Subsidies, payable D.3							
Current transfers D.7							
TOTAL CURRENT EXPENDITURE			**0.2**	**0.3**	**0.2**	**0.2**	**0.1**
Gross fixed capital formation P.51g							
Capital transfers D.9							
TOTAL CAPITAL EXPENDITURE			**0.1**	**0.3**	**0.5**	**0.6**	**0.3**

Other costs financed by RRF grants (% of GDP)

	2020	2021	2022	2023	2024	2025	2026
Reduction in tax revenue							
Other costs with impact on revenue							
Financial transactions							

Source: Ministry of Development Funds and Regional Policy.